



IRS Form 1099-C: Cancellation of Debt

Overview

This document is designed to provide information and instruction for individuals who have received a **Cancellation of Debt (COD)** IRS Form 1099-C.

If you have reached a compromise or settlement with a creditor agreeing to release you from any further obligations regarding the repayment of a debt, a credit card debt for example, your responsibilities may not end at this point. Your creditor may "write off" all or part of the debt it claims that you owe, and report it as a tax loss to the IRS using a Form 1099-C.

Because you never paid the debt-claim in full, the IRS can treat a cancellation of a debt-claim as income you have received. For example, \$4,500 credit card bill in which a compromise has been reached to settle the debt for \$2,500 is in theory a \$2,000 personal net gain. The IRS may require you to report this as income you have received for the tax year even though you have not actually received the money.

Why did I receive a 1099-C: Cancellation of Debt form?

If you have defaulted (failed to make payments as agreed) on a debt in the past and you have either reached a compromise with a creditor to settle your debt, or the creditor has deemed the debt to be non-collectable and has stopped attempts to recover, you may receive a 1099-C form. The IRS definition of a compromise in a collection case is the discharge of indebtedness under an agreement between the creditor and the debtor to cancel the debt at less than full consideration.

What is a 1099-C: Cancellation of Debt form?

A 1099-C form lets you know that a creditor is going to "write off" the remaining unpaid portion of your debt. An IRS 1099-C: Cancellation of Debt form is filed by a creditor to the IRS when a settlement agreement between a debtor and a creditor has been reached or when a creditor has determined that a debt will never be paid. If the debt is for \$600 or more the creditor must send you, the debtor, form 1099-C in the mail by January 31st and to the IRS by February 28th of the tax year in which the debt was discharged.

What should I do after I receive a 1099-C: Cancellation of Debt form?

If you receive a 1099-C form from a creditor, you must report the amount of the canceled debt as income to the IRS even though you have not actually received the money. (The amount shown in Box 2 of the 1099-C form is the amount that must be reported as income.)

What debts are forgiven under a 1099-C: Cancellation of Debt form?

The IRS recognizes five situations where a cancelled debt does not have to be reported as income.

1. Bankruptcy – the debt was already discharged through a bankruptcy proceeding.
2. Insolvency – your total debts exceed your total assets at the time your debt was settled or deemed non-collectable.
3. Indebtedness is due to a qualified farm expense.
4. Indebtedness is due to certain real property business losses.
5. Discharge of your debt was treated as a gift. (Extremely rare)

If you are insolvent you need to explain this to the IRS in one of two ways. 1) By filling out IRS Form 982 (Can be difficult to understand): Reduction of Tax Attributes Due to Discharge of Indebtedness or 2) Attaching a detailed letter to your tax return explaining the calculation of your total debts and assets.

How do I know if I am insolvent?

You are deemed to be insolvent if your total liabilities (debts) are greater than your total assets. Completing the insolvency worksheet at the bottom of this document will help you determine if you were insolvent at the time your debt was discharged. For example, if your total liabilities are \$8,000 and your total assets at the time are \$6,000 you are insolvent in the amount of \$2,000. To determine the value of your assets use the fair market value rather than what you paid for them or what you think they are worth.

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Helpful tips to avoid problems if you have received a 1099-C.

- If you settle your debt for less than full consideration (paid in full) be sure to ask the creditor if they intend to submit a 1099-C form to the IRS.
- The name of the creditor may not be readily recognizable on the 1099-C form. The creditor may have sold the debt to a third party collection agency or the name of the parent company could be listed as the creditor.
- Look to see if the added income received from a debt cancellation will move you into a higher tax bracket. For a taxpayer in the 35% tax bracket in 2005, a \$5,000 canceled debt could cost up to \$1,750 in additional income taxes.
- You cannot claim that you never received a 1099-C form in the mail. Even if you do not receive a 1099-C form you are expected to recognize ordinary income.

If you wish to obtain this service from Integrity to apply for I.R.S. debt cancellation,

****Integrity Financial and Tax Services, Inc. is providing this service.**

The back page of this form will be forwarded to them and you will receive your application letter directly from Integrity. Currently their fee for processing and creating the letter is \$75.

*** Note: They are a Financial & Tax Service company, not affiliated with Thompson + Brown Real Estate)*

December 8, 2006

Internal Revenue Service
(IRS's Address)
(City, State Zip)

Re: (Client name and social
security number)

SAMPLE

My client received Form 1099-C for the tax year 20XX from (Name of creditor company or bank) in the amount of \$(dollar amount listed on the 1099-C).

The debt to (Name of creditor company or bank) was a (Type of debt such as credit card, personal loan, deficiency balance on mortgage or car, etc.) that was unable to be paid off.

According to **IRC Sections 61 (a) 12, 108 (a) 1B, and IRS Publication 908**, this charged off or canceled debt is taxable income, unless one of four exceptions applies. My client case qualifies for the following common exception:

- Insolvency-Total liabilities were greater than total assets at the time the debt was forgiven. An itemized list of liabilities and assets at that time is attached for your information.

Since the above exception applies, the amount reported to you on Form 1099-C will not be included on the taxpayer's tax return for the year 20XX.

Sincerely,

Your,
Tax Accountant

Attachments:

- Statements of Liabilities and Assets

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[Insolvency Worksheet – Please Return This Page]

Statement of Total Assets and Liabilities To Determine Insolvency

Name: _____
 Last 4 digits SS #: _____
 Tax Year: _____

Name: _____
 Last 4 digits SS #: _____
 Tax Year: _____

Assets as of (Date) _____:

Liabilities as of (Date) _____:

Home(s): \$ _____
 Auto(s): \$ _____
 Bank Accounts: \$ _____
 Personal Property: \$ _____
 Stocks & Investments: \$ _____
 Business Interest: \$ _____
 Other: \$ _____

Credit Card Debt: \$ _____
 Mortgage(s): \$ _____
 Auto Loan(s): \$ _____
 Consumer Loan(s): \$ _____
 Other Liabilities: \$ _____
 Other: \$ _____
 Other: \$ _____

TOTAL ASSETS \$ _____

TOTAL LIABILITIES \$ _____

TOTAL LIABILITIES <Less> TOTAL ASSETS = \$ _____
Amount of Insolvency

(Note: In order to be "insolvent", total liabilities must be greater than total assets.)

The above information provided above is an accurate accounting of my/our assets and liabilities as of this date.

Name: _____
 Date: _____

Name: _____
 Date: _____

*****Legal Terms:**

Creditor – A person or business to whom another person who is the "debtor" owes a debt.

Debtor – One who owes a debt to a creditor.

Write off – To cancel from accounts as a loss.

Default – To fail to pay money when it is due.

Fair Market Value (FMV) – Price at which a willing seller and a willing buyer will trade.

Net Gain – An increase in the value of a capital asset.

Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment)

OMB No. 1545-0046

Department of the Treasury
Internal Revenue Service

▶ Attach this form to your income tax return.

Attachment
Sequence No. **94**

Name shown on return

Identifying number

Part I General Information (see instructions)

- 1 Amount excluded is due to (check applicable box(es)):
 - a Discharge of indebtedness in a title 11 case
 - b Discharge of indebtedness to the extent insolvent (not in a title 11 case)
 - c Discharge of qualified farm indebtedness
 - d Discharge of qualified real property business indebtedness
 - e Discharge of certain indebtedness of a qualified individual by reason of Hurricane Katrina
- 2 Total amount of discharged indebtedness excluded from gross income 2
- 3 Do you elect to treat all real property described in section 1221(a)(1), relating to property held for sale to customers in the ordinary course of a trade or business, as if it were depreciable property? Yes No

Part II Reduction of Tax Attributes. You must attach a description of any transactions resulting in the reduction in basis under section 1017. See Regulations sections 1.1017-1 and 1.1017-1T for basis reduction ordering rules, and, if applicable, required partnership consent statements. (For additional information, see the instructions for Part II.)

Enter amount excluded from gross income:		
4	For a discharge of qualified real property business indebtedness, applied to reduce the basis of depreciable real property	4
5	That you elect under section 108(b)(5) to apply first to reduce the basis (under section 1017) of depreciable property	5
6	Applied to reduce any net operating loss that occurred in the tax year of the discharge or carried over to the tax year of the discharge	6
7	Applied to reduce any general business credit carryover to or from the tax year of the discharge	7
8	Applied to reduce any minimum tax credit as of the beginning of the tax year immediately after the tax year of the discharge	8
9	Applied to reduce any net capital loss for the tax year of the discharge including any capital loss carryovers to the tax year of the discharge	9
10	Applied to reduce the basis of nondepreciable and depreciable property if not reduced on line 5. <i>DO NOT use in the case of discharge of qualified farm indebtedness.</i>	10
11	For a discharge of qualified farm indebtedness, applied to reduce the basis of:	
	a Depreciable property used or held for use in a trade or business, or for the production of income, if not reduced on line 5	11a
	b Land used or held for use in a trade or business of farming	11b
	c Other property used or held for use in a trade or business, or for the production of income	11c
12	Applied to reduce any passive activity loss and credit carryovers from the tax year of the discharge	12
13	Applied to reduce any foreign tax credit carryover to or from the tax year of the discharge	13

Part III Consent of Corporation to Adjustment of Basis of its Property Under Section 1082(a)(2)

Under section 1081(b), the corporation named above has excluded \$ from its gross income for the tax year beginning and ending

Under that section, the corporation consents to have the basis of its property adjusted in accordance with the regulations prescribed under section 1082(a)(2) in effect at the time of filing its income tax return for that year. The corporation is organized under the laws of

(State of Incorporation)

Note. You must attach a description of the transactions resulting in the nonrecognition of gain under section 1081.